Financial Markets

Irving Trust

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Friday

November 30, 1979

The credit markets rallied through most of the week, initially in response to Monday's decision by one New York bank to drop its prime rate 1/4% to 15 1/2%. Over the course of the week, this move was followed by most other major banks, one of which moved to a 15 1/4% prime. But the main driving force behind the rally was the easier tone in the money markets, and the resulting decline in Federal funds, that many market participants were interpreting as a sign of a more accommodating policy on the part of the Federal Reserve. With the stalemate over the Iranian hostage situation assuming a neutral near-term bearing on the market, prices pushed up by 1-1 1/2 points or more in the bond markets, and money market rates dropped as much as 75-110 basis points for the week.

The reported 1% increase in October consumer prices squared with most estimates and had no noticeable effect on the domestic markets. However, the behavior of inflation cannot be ignored in assessing the near-term interest rate outlook. The Fed's Chairman, Paul Volcker, has conditioned credit easing on progress in the inflation fight. Moreover, the still shaky dollar remains a further constraint on policy options. Indeed foreign market analysts were somewhat perplexed that U.S. rates were dropping even as the 12% annual rate of CPI increase was reported, one reason the dollar weakened considerably despite the news that strong exports had helped narrow the U.S. trade deficit in October. Until inflation cools visibly, foreign investors can be expected to view unfavorably any suggestion that the credit authorities are pushing interest rates down, particularly as rates abroad are being pushed still higher.

More important to the immediate rate outlook is the significance of recent Fed actions in the Federal funds market. After trading as high as 15 1/2% immediately after the October 6 monetary policy actions, funds moved down to as low as 13% before the Fed absorbed reserves from the banking system. After the November 20 meeting of the Federal Open Market Committee, reserve draining actions came as funds traded at 12%. But at the October 6 FOMC meeting, the committee adopted a Fed funds tolerance range of 11 1/2% to 15 1/2%, aware that its new reserve-oriented operating approach would require "...much greater fluctuations in the federal funds rate than heretofore." Moreover, at a subsequent special October 22 meeting, the FOMC considered an increase in the upper limit of the funds target in response to excessive growth in total reserves. With reserve growth so far showing little sign of slowing down, it is unlikely that the FOMC would have voted at last week's meeting either to lower its funds tolerance range or raise its reserve growth targets. Thus, in the new policy environment, the recent fluctuations in Federal funds don't carry the same implications as in the past and don't necessarily indicate a shift toward easier policy.

Glenn C. Picou

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Money Market Rates

	11/30/79 (noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	15.50%	15.75%	11.50%
Effective since	11/30/79		
Discount Rate at Federal Reserve Bank	12.00	12.00	9.50
Federal Funds	12.46	12.38	9.85
Repurchase Agreements	11.50	12.00	9.60
U.S. Treasury Issues - Yields			
Bills			
3 months	11.89	11.85	9.20
6 months	12.26	12.40	9.75
1 year	11.91	12.10	10.04
Coupons			
2 years	11.34	11.82	9.45
4 years	10.50	11.05	8.96
7 years	10.45	10.65	8.84
10 years	10.36	10.53	8.80
Long Bond	10.08	10.24	8.72
Negotiable Certificates of Deposit-Secondary Market			
1 month	12.90	13.30	9.95
3 months	13.10	13.55	10.70
6 months	13.25	13.55	11.25
1 year	12.40	13.25	11.00
Bankers' Acceptances			
1 month	12.90	13.30	10.00
3 months	13.25	13.60	10.40
6 months	13.30	13.70	10.60
Eurodollar Deposits			
1 month	13.63	13.63	11.00
2 months	14.13	14.63	11.13
3 months	14.38	14.63	11.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	10.13	8.00	9.01
1 month	12.00	13.00	9.96
3 months	11.75	12.63	10.12
Bank Holding Companies			
1 month	11.75	13.13	9.96
Dealer Placed:			
3 months	12.50	13.38	10.52
New Aa Corporate Utility Bond	11.75	11.75	9.25
Tax Exempt			
6 month Project Notes	6.15	6.40	5.20
12 month Project Notes	6.40	6.50	5.45
20 year AAA Bond	6.60	7.00	5.60

This information represents prevailing market yields. It should not be construed as an offering. All yields are on the offered side of the market.

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